SMARTCOOL™

Smartcool Systems Inc. (TSX-V: SSC)
Consolidated Financial Statements

For the years ended December 31, 2013 and 2012
Expressed in Canadian Dollars

www.smartcool.net

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Smartcool Systems Inc.

We have audited the accompanying consolidated financial statements of Smartcool Systems Inc. (the "Company") which comprise the consolidated statements of financial position as at 31 December 2013 and 2012 and the consolidated statements of operations, comprehensive income (loss), cash flows and shareholders' equity for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2013 and 2012 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements, which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about the ability of the Company to continue as a going concern.



Chartered Accountants

Vancouver, Canada
25 April 2014

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Smartcool Systems Inc.
Consolidated statements of financial position
(Expressed in Canadian dollars, unless otherwise stated)

	December 31, 2013	December 31, 2012
	$	$
ASSETS		
Current assets		
Cash and cash equivalents (note 3)	28,036	247,150
Trade and other receivables (note 4)	247,496	749,136
Inventory (note 5)	223,642	314,484
Prepaid expenses and deposits	91,120	65,244
	590,294	1,376,014
Property and equipment (note 6)	83,834	157,069
Intangible assets (note 7)	3,503,047	3,934,093
Total assets	**4,177,175**	**5,467,176**
LIABILITIES		
Current liabilities		
Trade payables and accruals (notes 9 and 18)	801,077	940,868
Short-term loan (note 10)	131,111	-
Current portion of obligations under acquistion contracts (note 11)	166,295	2,536,357
Current portion of finance leases (note 12)	-	19,409
Current portion of debentures (note 13)	149,712	348,520
Current portion of deferred tenant inducement	16,166	15,052
	1,264,361	3,860,206
Obligations under acquisition contracts (note 11)	235,712	-
Debentures (note 13)	99,371	-
Deferred tenant inducement	6,744	22,911
Deferred tax liability (note 15)	445,754	477,277
Total liabilities	2,051,942	4,360,394
SHAREHOLDERS' EQUITY		
Share capital (note 14(a))	30,309,075	29,835,392
Reserve for equity settled share based transactions (note 14(b)(c))	5,847,515	5,712,544
Foreign currency translation adjustment	(129,636)	(131,138)
	36,026,954	35,416,798
Deficit	(33,901,721)	(34,310,016)
	2,125,233	1,106,782
Total liabilities and shareholders' equity	**4,177,175**	**5,467,176**

Approved and authorized for issue by the Board of Directors on April 22, 2014

"George Burnes"	"Jeffrey Lowe"
George Burnes	Jeffrey Lowe

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statements of operations
(Expressed in Canadian dollars, unless otherwise stated)

	December 31, 2013	December 31, 2012
	$	$
Revenue	1,667,957	4,212,750
Cost of sales	530,629	1,793,003
Gross profit	1,137,328	2,419,747
Operating Expenses		
General and administrative expenses (note 20)	2,308,343	3,209,334
Share-based payments (note 14(b))	82,278	123,158
Research and development (note 8)	29,430	29,667
Amortization and depreciation (notes 6 and 7)	665,821	1,096,438
	3,085,872	4,458,597
Operating loss	(1,948,544)	(2,038,850)
Rental income (note 16)	116,028	85,863
Impairment of intangible assets (note 7)	-	(83,787)
Finance expense	(252,538)	(270,281)
Finance income (note 20)	77	196
Foreign exchange loss	(39,676)	(1,763)
Gain on debt settlement (notes 11 and 13)	2,514,205	-
Gain (loss) on sale of property and equipment (note 6)	732	(1,777)
	2,338,828	(271,549)
Income taxes recovery (note 15)	18,011	378,127
Net income (loss) for the year	**408,295**	**(1,932,272)**
Net income (loss) per share		
Basic	0.01	(0.03)
Diluted	0.01	(0.03)
Weighted average number of common shares outstanding (basic and diluted)	**71,259,900**	**64,148,246**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statements of comprehensive income (loss)
(Expressed in Canadian dollars, unless otherwise stated)

	December 31, 2013	December 31, 2012
	$	$
Net income (loss) for the year	**408,295**	**(1,932,272)**
Foreign currency translation adjustment	1,502	(77,148)
Total comprehensive income (loss)	**409,797**	**(2,009,420)**
Net comprehensive income (loss) per share		
Basic	**0.01**	**(0.03)**
Diluted	**0.01**	**(0.03)**
Weighted average number of common shares outstanding (basic and diluted)	**71,259,900**	**64,148,246**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statements of cash flows
(Expressed in Canadian dollars, unless otherwise stated)

	December 31, 2013	December 31, 2012
	$	$
Cash flows from operating activities		
Income (loss) for the year	408,295	(1,932,272)
Items not affecting cash:		
Depreciation of property and equipment	67,153	95,095
Amortization of intangible assets	598,668	1,001,343
Impairment of intangible assets	-	83,787
Loss (gain) on sale of property and equipment	(732)	1,777
Gain on debt extinguishmnet	(2,514,205)	-
Share-based payments	82,278	123,158
Deferred tax liability	(31,523)	(135,833)
Deferred tenant inducement	(15,053)	(13,492)
Unrealized foreign exchange (gain) loss	47,397	(7,908)
Accrued interest on short term loan	6,111	-
Accrued interest on debentures	70,550	(19,733)
Accrued interest of obligation under acquisition contract	168,040	165,718
Accretion of obligation under acquisition contract	3,134	39,900
	(1,109,887)	(598,460)
Changes in non-cash working capital items:		
Trade and other receivables	501,640	309,212
Inventory	90,842	210,609
Prepaid expenses and deposits	(25,876)	81,542
Trade payables and accruals	(139,791)	(269,302)
Net cash flows used in operating activities	(683,072)	(266,399)
Cash flows from investing activities		
Disposal of property and equipment	10,581	9,818
Purchase of property and equipment	(2,499)	(89,807)
Net cash from (used in) provided by investing activities	8,082	(79,989)
Cash flows from financing activities		
Shares and warrants issued for cash, net of issue costs	473,683	369,923
Short-term loans	125,000	-
Decrease in debentures	(124,900)	(128,755)
Decrease in acquisition contract obligation	-	(38,525)
Decrease in finance leases	(19,409)	(30,831)
Net cash from financing activities	454,374	171,812
Net decrease in cash and cash equivalents	(220,616)	(174,576)
Effects of exchange rates changes on cash	1,502	(77,148)
Cash and cash equivalents, beginning of year	247,150	498,874
Cash and cash equivalents, end of year	28,036	247,150

Supplemental cash flow information (note 21)

See accompanying notes to the consolidated financial statements

SMARTCOOL™

Smartcool Systems Inc.
Consolidated statements of shareholders' equity
(Expressed in Canadian dollars, unless otherwise stated)

	Share capital	Reserve for equity settled share based transactions	Foreign currency translation adjustment	Deficit	Total shareholders' equity
	$	$	$	$	$
Balance at January 1, 2012	**29,465,469**	**5,589,386**	**(53,990)**	**(32,377,744)**	**2,623,121**
Net loss	-	-	-	(1,932,272)	(1,932,272)
Foreign currency translation adjustment	-	-	(77,148)	-	(77,148)
Total comprehensive loss for the year	-	-	(77,148)	(1,932,272)	(2,009,420)
Shares issued for:					
Private placement	375,000	-	-	-	375,000
Share issue costs	(5,077)	-	-	-	(5,077)
Share-based payments	-	123,158	-	-	123,158
Balance at December 31, 2012	**29,835,392**	**5,712,544**	**(131,138)**	**(34,310,016)**	**1,106,782**
Net income				408,295	408,295
Foreign currency translation adjustment	-	-	1,502	-	1,502
Total comprehensive income for the year	-	-	1,502	408,295	409,797
Shares issued for:					
Private placement	500,000	-	-	-	500,000
Warrants	-	52,693	-	-	52,693
Share issue costs	(26,317)	-	-	-	(26,317)
Share-based payments	-	82,278	-	-	82,278
Balance at December 31, 2013	**30,309,075**	**5,847,515**	**(129,636)**	**(33,901,721)**	**2,125,233**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Notes to the consolidated financial statements
For the year ended December 31, 2013
(Expressed in Canadian dollars, unless otherwise stated)

1. Nature of Operations and Going Concern

Smartcool Systems Inc. ("Smartcool" or the "Company"), which was incorporated on August 31, 2000 under the Canada Business Corporations Act as 378211 Canada Inc., changed its name to Citotech Systems Inc. on October 16, 2000, and changed its name again to Smartcool Systems Inc. on July 20, 2004.

In 2004, the Company incorporated a wholly owned subsidiary, Smartcool Systems (USA) Inc. ("Smartcool USA"), under the laws of Nevada. Smartcool International Inc. ("Smartcool International"), another wholly owned subsidiary, was incorporated in Barbados in June 2006. In April 2008, the Company completed the incorporation of its subsidiary, Smartcool Systems (EMEA) Ltd. ("Smartcool EMEA"), headquartered in Alton, England. In February 2011, Smartcool EMEA acquired all the outstanding shares of Smartcool Systems UK ("Smartcool UK"), also headquartered in Alton, England.

The Company's shares are listed on the TSX Venture Exchange and the head office, principal address, and registered office is located at 1196 Marine Drive, North Vancouver, BC, V7P 1S8.

Smartcool and its subsidiaries are focused on acquiring, commercializing, and marketing energy saving technologies for commercial and retail businesses. Currently the Company has two principal revenue streams: the sale and installation of the ESM™ & ECO3™ to end customers and to distributors worldwide.

The ESM™ is manufactured by a third party in Australia and is designed specifically to reduce the electricity consumption and maximum demand of refrigeration and air conditioning compressors by improving their performance and maintaining temperature control. The ESM™ uses microprocessor technology and software algorithms.

Introduced in early 2009, the ECO3™ is manufactured in China and is a simple retrofit product that can be installed on any air conditioning, heat pump or refrigeration unit with one or two compressors, achieving the same energy efficiency gains as the ESM™ for these smaller systems.

During the year ended December 31, 2013, the Company had a net income of $408,295 (2012 – net loss of $1,932,272) and a deficit of $33,901,721 as at December 31, 2013 (2012 - $34,310,016). As at December 31, 2013, the Company had negative working capital of $674,067 (2012 - $2,484,192).

The Company has successfully negotiated a reduction of its acquisition obligations and further improved its working capital by obtaining capital financing in 2013. To ensure that the Company continues to be a going concern through 2014, the Company has reduced its manufacturing costs significantly and secured more predictable revenue generation by way of software licensing.

Management has arranged with a UK bank to have a short term overdraft protection and continued to seek approval from this major banking relationship to provide accounts receivable factoring for select accounts that will smooth out the Company's cash flow.

The Company's ultimate success and the recoverability of its assets will depend on the Company's ability to successfully execute its business plan which includes a growing market for its products, achieving profitable operations, meeting its business acquisition obligations, the continued support of the Company's shareholders and employees, and the continued support from creditors with whom negotiations have been made and waivers obtained.

Management is aware, in making its assessment, that these material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. These consolidated financial statements do not reflect adjustments to the carrying value of assets and liabilities which may be required should the Company be unable to raise adequate financing or meet current obligations and therefore be unable to continue as a going concern.

2. Significant Accounting Policies

Basis of Presentation and Statement of Compliance

The consolidated financial statements of the Company and its subsidiaries, including comparative, have been prepared in accordance with and using accounting policies in full compliance with International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS") issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"), effective for the Company's reporting for the year ended December 31, 2013.

The Company's consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments which are measured at fair value, as explained in Note 19, and are presented in Canadian dollars except where otherwise indicated.

Use of Estimates and Judgments

The preparation of these consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates and assumptions. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are outlined below. Actual results may differ from those estimates.
Significant estimates are used for, but not limited to, assessment of impairment of intangible assets and recoverability of long-lived assets, determination of present value of obligations under acquisition contract, determination of fair value of debentures, valuation of stock options and warrants, recoverability of trade and other receivables, inventory valuation, determination of valuation allowance for income tax assets, amortization rates and methods and ability to continue as a going concern.

Judgments made by management in the application of IFRS that have a significant effect on the consolidated financial statements and estimates with a significant risk of material adjustment in the current and following fiscal years are discussed below:

- Useful lives – the useful lives of intangible assets and the related depreciation
- Impairment – the assessment of impairment of intangible assets and goodwill
- Inventory valuation – the provision for obsolescence of inventory and net realizable value
- Receivable valuation – the recoverability of trade receivables
- Share-based payments – the inputs used in accounting for share-based payments
- Debentures – discount rate used in fair value calculation of the debentures
- Contingencies – any future contingencies and commitments
- Going concern – the assessment of the Company's ability to continue as a going concern

Basis of Consolidation

The Company consolidates subsidiaries controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Smartcool USA, Smartcool International, Smartcool EMEA and Smartcool UK from February 28, 2011, the date of acquisition. All inter-company transactions, balances, revenues and expenses, have been eliminated. The financial statements of the subsidiaries are prepared for the same reporting period as the parent Company, using consistent accounting policies, in all material aspects.

Business Combinations and Goodwill

A business combination is defined as an acquisition of assets and liabilities that constitute a business. A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return to the Company and its shareholders in the form of dividends, lower costs, or other economic benefits. A business consists of inputs, including non-current assets, and processes, including operational processes, that when applied to those inputs, have the ability to create outputs that provide a return to the Company and its shareholders. A business also includes those assets and liabilities that do not necessarily have all the inputs and processes required to produce outputs, but can be integrated with the inputs and processes of the Company to create outputs.

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognized in profit or loss as incurred.
Where the fair value of the identifiable net assets acquired exceeds the cost of the acquisition, the surplus, which represents the discount on the acquisition, is recognized directly in the statement of operations in the period of acquisition. Where the fair value of consideration paid exceeds the fair value of net identifiable tangible and intangible assets, goodwill is recognized.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquire are assigned to those units.

Foreign Currency

The functional currency of Smartcool and Smartcool International has been determined to be the Canadian dollar. The functional currency of Smartcool USA is the United States dollar. The functional currency of Smartcool EMEA and Smartcool UK is the British pound. The consolidated financial statements have been translated to the Canadian dollar in accordance with IAS 21, "The Effects of Changes in Foreign Exchanges Rates".

The assets and liabilities of foreign operations are translated into Canadian dollars at the exchange rate at period end and income statement items are translated using the exchange rates at the date of the transactions. All resulting exchange differences are taken directly to a separate component of the foreign currency translation reserve. On disposal of a foreign operation, the deferred cumulative amount recognized in the foreign currency translation reserve relating to that particular foreign operation is recognized in foreign exchange gain and loss.

For foreign subsidiaries where the Canadian dollar is the functional currency, non-monetary assets and liabilities are translated to Canadian dollars using the exchange rate in effect at the original transaction date. Monetary balances are translated at rates of exchange at the period end date. The translation difference resulting from translating the foreign currencies to Canadian dollars is recorded as a component of foreign exchange gain and loss.

Revenue Recognition

Revenue from the sale and installation of the ESM™ and ECO3™ is recognized when the ESM™ & ECO3™ have been installed, significant risks and rewards of ownership of the equipment have been transferred to the customer, the Company does not retain continuing managerial involvement or effective control over the equipment, the sales price can be determined and collection is probable, and the cost of the transaction can be measured reliably.

Revenue from the international distribution of the ESM™ & ECO3™ is recognized when the equipment has been shipped, title has been transferred, the sales price has been determined and the cost of the equipment can be measured reliably. Revenue is also recognized when equipment has been ordered and laid away as instructed by the customer, the sales price has been determined and a significant portion of it has been paid. Provisions are established for estimated warranty costs at the time revenue is recognized.

The Company records deferred revenue when cash is received in advance of the above revenue recognition criteria being met.

Warranty

The Company provides for future warranty costs based on management's best estimates of such costs, taking into account past experience and warranty provisions of distribution and sale agreements.

Share-based Payments

The fair value of all stock options granted to employees is determined using the Black-Scholes Option Pricing Model, and the resulting value is charged to operations over the vesting period. Volatility rate is determined based on the trading history of the Company's shares for the relevant period and interest rate is based on Canadian bond rates.

The fair value of options granted to non-employees is determined using fair value of the goods or services received. The resulting value is charged to operations when a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. To estimate the fair value of options granted to non-employees, management considers primarily the fees management would be willing to pay in cash for the service if no options were granted.

A corresponding increase in equity reserve is recorded when stock options are expensed. When stock options are exercised, share capital is credited by the sum of the consideration paid and the related portion previously recorded in equity reserve is reversed. At the time of grant, the expense is determined based on estimated forfeiture rate. The expense will be adjusted to recognize the effect of actual forfeitures as they occur. The fair value of warrants issued to agents for their finder's fee is based on the fair value of the services provided and charged to share issuance costs.

When the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee as measured at the date of modification.

Inventory

Inventory is recorded at the lower of cost and net realizable value. Costs of inventories are determined using the weighted average cost method. Cost of inventory includes invoiced cost from the manufacturer and other costs in bringing the inventory to their present location and condition and net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Amortization is computed using the straight line method over the assets' estimated useful lives, less their estimated residual value, at the following rates:

Computer hardware	2-3 years
Computer software	1-5 years
Testing and demonstration equipment	2-3 years
Office equipment and furniture	4-5 years
Motor vehicles	4 years
Leasehold improvements	Shorter of term of the lease and useful life

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on the disposal of the asset is calculated as the difference between the net disposal proceeds and the carrying value of the asset, and recognized in profit or loss.

Residual value and estimated useful lives are reviewed annually.

Intangible Assets

a. *Research and development*

Research costs are expensed as incurred. Development costs are expensed as incurred unless they can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use the asset. The Company has determined that as at September 30, 2008, development costs of $106,561 have met these criteria. The costs were fully amortized during 2010.

b. *Goodwill*

Goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized in the statement of operations.

c. *Other intangible assets*

Intangible assets are recorded at cost and include the ESM™ brand, ESM™ intellectual property, distribution rights, distribution agreements, supplier agreements and customer relationship. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The ESM™ brand has been determined to have an indefinite life and is not amortized. The remaining intangible assets with finite lives are amortized on a straight-line basis. During the year ended 31 December 2013, management re-assessed the useful lives of the remaining intangible assets as follows:

	2013	2012
ESM™ Intellectual property	13.5 years	10 years
North American distribution rights	10 years	10 years
TECC and United Kingdom distribution rights	9.5 - 12 years	5 - 9 years
Distribution agreements	13.5 - 15 years	10 - 15 years
Supplier agreements	13.5 years	10 years
Customer relationship	12 years	5 years

Total amortization for the year ended December 31, 2013 of $598,668 (2012 - $1,001,343) was included under net income (loss) for the year on the statement of operations (note 7).

Residual value and estimated useful lives are reviewed annually. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates.

Impairment

a. *Property, equipment and intangible assets with a finite useful life*

Property, equipment and intangible assets with a finite life are assessed for indications of impairment at the end of each reporting period. If such indications exist, then the recoverable amount of the asset or cash-generating unit ("CGU") is estimated.

An impairment loss is recognized when the carrying amount of the asset or CGU exceeds its recoverable amount. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset or CGU.

Impairment losses are recognized in respects to CGU's are first allocated to reduce the carrying amount of any goodwill allocated to the CGUs, and then to reduce the carrying amount of the other assets in the unit on a pro-rata basis. Impairment losses are recognized in profit and loss for the period it is identified.

b. *Intangible assets with an indefinite useful life*

Intangible assets with an indefinite life are reviewed and tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. The asset is written down when the carrying amount exceeds its recoverable amount. The ESM™ brand is considered to have an indefinite life as the Company has a global market and there is no direct competition for its instinctive green technology.

Reversal of Impairment

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss has been recognized. An impairment loss with respect to goodwill is never reversed.

c. *Financial assets*

Financial assets, other than those at fair value through profit and loss ("FVTPL"), are assessed for indicators of impairment at each period end. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Impairment of financial assets carried at amortized cost, is the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of all financial assets, excluding trade and other receivables, is directly reduced by the impairment loss. Uncollectible amounts in trade and other receivables are written off against the allowance account.

Available-for-sale financial assets are impaired if the cost (net of any principal payment and amortizations) is greater than the current fair value, less any impairment previously recognized in profit and loss. The impairment amount is transferred from equity to the statement of operations. Reversals of available-for-sale financial assets are not recognized in profit.

For all other financial assets carried at amortized cost in which impairment was previously recognized, if subsequent measurement indicates that the recorded impairment has decreased, and the decrease can be related objectively to an event occurring after the impairment was recognized, then the reversal of the impairment is recognized in the statement of operations. On the date of the impairment reversal, the carrying value of the financial asset cannot exceed its amortized cost had impairment not been recognized.

Financial Instruments

a. *Financial assets*

The Company classifies its financial assets in the following categories: FVTPL, held to maturity investments, available-for-sale financial assets, and loans and receivables. The classification depends on the nature and purpose for which the financial assets were acquired. Management determines the classification of financial assets at initial recognition.

i. Financial assets at FVTPL

Financial assets are classified as FVTPL when the financial asset is held for trading or is designated as FVTPL on initial recognition.

A financial asset is classified as held for trading when it is purchased and incurred with the intention of generating profits in the near term, part of an identified portfolio of financial instruments that the Company manages and has actual pattern of short-term profit-taking; or is a derivative that is not designated and effective as a hedging instrument.

Financial assets classified as FVTPL are stated at fair value with any resulting gain or loss recognized in profit or loss. Transaction costs are expensed in the period in which the costs are incurred.

The Company's only financial asset classified as FVTPL is cash and cash equivalents.

Cash and cash equivalents consist of cash on deposit and highly liquid investments that are readily convertible into cash with maturities of three months or less when purchased.

ii. Held to maturity investments

Held to maturity investments are measured at amortized cost using the effective interest rate method. Transaction costs are added and amortized to the statement of operations over the life of the financial instrument on an effective yield basis.

The Company classifies short-term investments of interest bearing term deposits with maturity dates of more than three months as held to maturity investment. Interest on these term deposits is recognized in the consolidated statement of operations using the effective interest method.

The Company did not hold any held-to-maturity investments as at December 31, 2013 and December 31, 2012.

iii. Available-for-sale financial assets

Financial assets classified as available-for-sale are carried at fair value (where determinable based on market prices of actively traded securities) with changes in fair value recorded in other comprehensive income. Available-for-sale securities are written down to fair value through earnings whenever it is necessary to reflect other-than temporary impairment.

The Company did not hold any available-for-sale financial assets as of December 31, 2013 and December 31, 2012.

iv. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment.

The Company classifies trade and other receivables as loans and receivables.

v. Derecognition of financial assets

A financial asset is derecognized when the contractual right to the asset's cash flows expires or if the Company transfers the financial asset and substantially all risks and rewards of ownership to another entity.

b. ***Financial Liabilities***

Financial liabilities are classified as either financial liabilities at FVTPL or other financial liabilities.

i. **Other financial liabilities**

Other financial liabilities are initially measured at fair value, net of transaction costs, and subsequently measured at amortized cost, with any resulting premium or discount from the face value being amortized to income or expense using the effective interest method.

The Company classifies trade payables, short-term loan, obligations under acquisition contracts, finance leases, and debentures as other financial liabilities.

ii. **Derecognition of financial liabilities**

The Company derecognizes financial liabilities when, and only when, the Company's obligations are discharged, cancelled, or expired. A substantial modification of the terms of a financial liability or a part of it is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The difference between the carrying amount of the financial liability extinguished and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognized in profit or loss.

Share Purchase Warrants

The Company issues common shares and share purchase warrants as a unit as well as units of debenture and share purchase warrants. The unit price is allocated to common shares and warrants based on their relative fair values. The residual method is used to allocate the value of debentures and warrants. The fair value of common shares is the market price on the date of issue and the fair value of warrants is determined using the Black-Scholes Option Pricing Model. Because the Black-Scholes Option Pricing Model requires the input of highly subjective assumptions, including the volatility of share price, changes in subjective input assumptions can materially affect the fair value estimate.

The Company also issues warrants to agents as compensation for services. The fair value of these warrants is determined to be the difference between agent's standard all-cash compensation and compensation with warrants. Warrants are also issued as non-cash consideration for business acquisitions. The fair value of these warrants is determined based on Black-Scholes Option Pricing Model.

Leases

Leases are classified as finance leases if the Company bears substantially all risks and rewards of ownership of the leased asset. At the inception of the lease, the asset is recognized at the lower of fair value and the present value of the minimum lease payments, and a corresponding amount is recognized as a finance lease obligation. The cost of the asset acquired under finance leases are depreciated on a basis consistent with that for depreciable assets that are owned. The cost of the asset is depreciated over the estimated useful lives or the lease term, whichever is shorter, when it is not reasonably certain that the Company will obtain ownership by the end of the lease term. Obligations recorded under finance leases are reduced by lease payments, net of finance charges. Finance charges are charged to net earnings (loss) over the lease term. All other leases are classified as operating leases. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

(Income) Loss per Share

Basic (income) loss per share is computed using the weighted average number of common shares outstanding during the year. Diluted loss per share amounts are calculated giving effect to the potential dilution that would occur if warrants and stock options were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate. The outstanding warrants and options to purchase common shares were excluded from the calculation of diluted loss per share, because their impact would have been anti-dilutive.

Income Taxes

Income tax expense (recovery) in the statement of operations for the periods presented comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is calculated using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit; the initial recognition of goodwill or a transaction, other than a business combination, that affects neither accounting profit nor taxable profit; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. To the extent that the Company does not consider it probable that a future tax asset will be recovered, the tax assets will be classified as unrecognized tax assets.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Comparative Figures

Certain comparative figures have been adjusted to conform to the current year's presentation.

Changes in Accounting Policies

A number of standards and amendments were issued effective for accounting periods beginning on or after January 1, 2013. Many of these updates are not applicable to the Company. As of January 1, 2013, the Company adopted the following IFRS standards and amendments:

- IFRS 10, "Consolidated Financial Statements", establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. This policy supersedes IAS 27, "Consolidated and Separate Financial Statements", and SIC-12, "Consolidation—Special Purpose Entities". Under this policy, control is based on whether an investor has:

  a. power over the investee
  b. exposure or rights to variable returns from investments with the investee
  c. the ability to use power over the investee to affect the amount of the investor's returns

- IFRS 13, "Fair Value Measurement", defines fair value and sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. This policy applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also requires the disclosure of certain information on fair value measurements.

- IAS 1(Amendment), "Presentation of Financial Statements", requires items of other comprehensive income be grouped based on their potential reclassifiability to profit and loss.

- IFRS 7, "Financial Instruments: Disclosures", provides additional disclosures related to offsetting financial assets and financial liabilities.

- IAS 19 (Amendment), "Employee Benefits", revises recognition and measurement of post-employment benefits.

The adoption of the above standards did not have a significant impact on the Company's consolidated financial statements.

Accounting Standards Issued but not yet Effective

At the date of authorization of these consolidated financial statements, the IASB and IFRIC have issued the following new and revised standards, amendments and interpretations which are not yet effective:

- IFRS 9, "Financial Instruments", is a new financial instruments standard effective for annual periods beginning on or after January 1, 2015 that replaces IAS 39 and IFRIC 9 for classification and measurement of financial assets and financial liabilities.

- IAS 32 (Amendment), "Financial Instruments: Presentation", is effective for annual periods beginning on or after January 1, 2014 and revises certain aspects of the requirements on offsetting.

- IFRS 10 (Amendment), "Consolidated Financial Statements", is effective for annual periods

beginning on or after January 1, 2014 and includes an exception to specific consolidation requirements for investment entities.

3. Restricted Cash

In 2010, the Company issued units of participation subordinated secured debentures and warrants through a private placement. Under the terms of the debenture, the holders are entitled to receive quarterly payments towards the principal amount. The total of quarterly payments is equal to 5% of the gross cash revenue received by the Company in each quarter. The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date. When such payments are delayed, the Company is required to deposit into a separate trust account, on a quarterly basis, an amount equal to any first year quarterly principal payment that would otherwise have been payable. On March 1, 2013, the terms of the debentures were amended (note 13).

As of December 31, 2013, total cash of $Nil has been designated as restricted cash (2012 - $66,833).

4. Trade Receivables

	December 31, 2013	December 31, 2012
[1]Trade receivables, net of allowances for doubtful accounts	$240,719	$742,684
Other receivables	6,777	6,452
	$247,496	**$749,136**

[1] Allowance for doubtful accounts as at December 31, 2013 was $619,342 (2012 - $584,656). This allowance consists primarily of receivables from Colt Technology Services ("Colt") of $594,466 (£337,247) (2012 - $545,599 (£337,247)). The Company has been in negotiations with Colt. This expense has been recorded in General and Administrative Expenses.

At December 31, 2013, the analysis of trade receivables that were past due but not impaired is as follows:

	December 31, 2013	December 31, 2012
Neither past due nor impaired	$88,133	$538,159
< 30 days	34,314	597
30-60 days	67,159	48,809
60-90 days	19,657	1,224
90-120 days	-	-
> 120 days	31,456	153,895
	$240,719	**$742,684**

All trade and other receivables are classified as current assets. In determining the recoverability of a trade or other receivable, the Company performs a risk analysis considering the type and age of the outstanding receivable, as well as the Company's exposure to credit and currency risks as disclosed in Note 19.

Included in trade and other receivables is $5,000 due from the Chief Executive Officer as at December 31, 2013 (2012 - $5,000) related to an advance for travel expenses. The amount is unsecured, non-interest bearing and have no fixed terms of repayment (note 18).

5. Inventory

	December 31, 2013	December 31, 2012
ESM™ ECO3™	$184,170	$251,859
Other products	39,472	62,625
	$223,642	**$314,484**

During the year ended December 31, 2013, total inventories of $334,272 were recognized as costs of sales (2012 - $411,864).

6. Property and Equipment

Cost

	Computers	Testing and demonstration equipment	Office equipment and furniture	Motor vehicles	Leasehold improvement	Total
Balance at January 1, 2012	**$179,855**	**$233,747**	**$52,261**	**$92,899**	**$116,318**	**$675,080**
Additions	82,171	801	6,835	-	-	89,807
Disposals	-	-	(15,380)	-	-	(15,380)
Effect of change in foreign exchange rates	412	(3,336)	1,066	2,229	-	371
Balance at December 31, 2012	**262,438**	**231,212**	**44,782**	**95,128**	**116,318**	**749,878**
Additions	2,102	-	397	-	-	2,499
Disposals	(2,075)	-	-	(25,165)	-	(27,240)
Effect of change in foreign exchange rates	4,369	12,931	2,002	5,447	-	24,749
Balance at December 31, 2013	**$266,834**	**$244,143**	**$47,181**	**$75,410**	**$116,318**	**$749,886**

Accumulated Depreciation and Impairment

	Computers	Testing and demonstration equipment	Office equipment and furniture	Motor vehicles	Leasehold improvement	Total
Balance at January 1, 2012	**$150,486**	**$220,765**	**$32,586**	**$22,861**	**$76,578**	**$503,276**
Depreciation	36,948	8,657	7,657	30,201	11,632	95,095
Disposals	-	-	(3,785)	-	-	(3,785)
Effect of change in foreign exchange rates	406	(3,411)	38	1,190	-	(1,777)
Balance at December 31, 2012	**187,840**	**226,011**	**36,496**	**54,252**	**88,210**	**592,809**
Depreciation	24,602	5,673	3,849	21,397	11,632	67,153
Disposals	(1,184)	-	-	(18,290)	-	(19,474)
Effect of change in foreign exchange rates	4,058	11,959	2,679	6,868	-	25,564
Balance at December 31, 2013	**$215,316**	**$243,643**	**$43,024**	**$64,227**	**$99,842**	**$666,052**

Carrying Value

	Computers	Testing and demonstration equipment	Office equipment and furniture	Motor vehicles	Leasehold improvement	Total
Balance at January 1, 2012	$29,369	$12,982	$19,675	$70,038	$39,740	$171,804
Balance at December 31, 2012	$74,598	$5,201	$8,286	$40,876	$28,108	$157,069
Balance at December 31, 2013	**$51,518**	**$500**	**$4,157**	**$11,183**	**$16,476**	**$83,834**

As at December 31, 2013, assets under capital lease with total cost of $75,410 (2012 - $95,128) and accumulated amortization of $64,227 (2012 - $54,252) are included in property and equipment for net book value of $11,183 (2012 - $40,876) (notes 12 and 18).

Amortization expense for assets under capital lease recorded in the statement of comprehensive loss for the year December 31, 2013 was $21,397 (2012 - $30,201).

During the year ended December 31, 2013, the Company sold property and equipment for proceeds of $10,581 (2012 - $9,818) resulting in a gain of $732 (2012 - $1,777 loss), of which proceeds of $Nil (2012 - $2,223) and a loss of $Nil (2012 - $1,777) related to property and equipment sold to Richards Buell Sutton LLP (note 18).

7. Intangible Assets

Indefinite Lives

As at December 31, 2013, ESM™ brand (b) had a carrying amount of $56,100 and is not subject to amortization due to having an indefinite useful life. Goodwill arising on the acquisition of Smartcool UK amounted to $1,213,283. The balance of goodwill outstanding at December 31, 2013 was $Nil as an impairment was assessed for the full amount during 2011.

Definite Lives

Cost	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreement (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
Balance at January 1, 2012	**$260,960**	**$124,100**	**$1,861,742**	**$113,651**	**$4,656,567**	**$1,053,090**	**$8,070,110**
Effect of change in foreign exchange rates	(3,978)	-	-	-	77,122	25,001	98,145
Balance at December 31, 2012	**256,982**	**124,100**	**1,861,742**	**113,651**	**4,733,689**	**1,078,091**	**8,168,255**
Effect of change in foreign exchange rates	12,366	-	-	-	303,091	96,560	412,017
Balance at December 31, 2013	**$269,348**	**$124,100**	**$1,861,742**	**$113,651**	**$5,036,780**	**$1,174,651**	**$8,580,272**

Amortization and impairment losses	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreements (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
Balance at January 1, 2012	**$150,059**	**$68,255**	**$820,187**	**$62,510**	**$1,697,167**	**$363,957**	**$3,162,135**
Amortization	25,780	12,410	148,332	11,363	637,182	166,276	1,001,343
Impairment	83,787	-	-	-	-	-	83,787
Effect of change in foreign exchange rate	(2,644)	-	-	-	35,563	10,078	42,997
Balance at December 31, 2012	**256,982**	**80,665**	**968,519**	**73,873**	**2,369,912**	**540,311**	**4,290,262**
Amortization	-	6,205	113,288	5,685	396,996	76,494	598,668
Impairment	-	-	-	-	-	-	-
Effect of change in foreign exchange rate	12,366	-	-	-	176,445	55,584	244,395
Balance at December 31, 2013	**$269,348**	**$86,870**	**$1,081,807**	**$79,558**	**$2,943,353**	**$672,389**	**$5,133,325**

Carrying amounts	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreement (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
As at January 1, 2012	$110,901	$55,845	$1,041,555	$51,141	$2,959,400	$689,133	$4,907,975
Balance at December 31, 2012	$ -	$43,435	$893,223	$39,778	$2,363,777	$537,780	$3,877,993
Balance at December 31, 2013	**$ -**	**$37,230**	**$779,935**	**$34,093**	**$2,093,427**	**$502,262**	**$3,446,947**

The Company also has the ESM brand, an indefinite life asset. As at December 31, 2013, the value of this asset was $56,100.

a. ***North American distribution rights***

On March 27, 2006, the Company acquired the exclusive rights to distribute the ESM™ throughout North America from Abbotly Technologies Inc. ("Abbotly USA"). Pursuant to the acquisition, Abbotly USA agreed to assign all of its rights and obligations, and the Company agreed to assume all of Abbotly USA's obligations, under a license agreement between Abbotly USA and Abbotly, and the Company became the master distributor of the ESM™ in North America.

Consideration paid for the acquisition was $201,953 (US$180,000), 500,000 share purchase warrants with an exercise price of $0.27 and a 20% royalty on certain products purchased from Abbotly as long as the Company still holds the distribution rights.

On December 31, 2012, the Company decided that the distribution agreement, expiring on March 6, 2013, will not be renewed under the terms set out in the existing agreement.

During the year ended December 31, 2013, management performed a review of the carrying value of these assets and an impairment loss of $Nil (2012 - $83,787) was recognized.

b. ***ESM™ Intellectual Property and worldwide distribution rights***

The Company acquired $2,278,350 of intangible assets in relation to the acquisition of Abbotly.

Management has performed a review of the carrying value of its distribution agreements. As a result of its assessment, in 2008, the Company recognized an impairment of $116,914 related to distribution agreements. As a result of this impairment recognition, the total cost of distribution agreements was reduced by $148,799 to $1,835,702. As at December 31, 2013, cost of distribution agreements consisted of:

ESM™ Distribution agreements (b)	$1,835,702
Other distribution rights	$26,040
Total	**$1,861,742**

During the year ended December 31, 2013, management reassessed the useful life of the ESM intellectual property to be 13.5 years (2012 – 10 years), and the useful life of the worldwide distribution rights to be 13.5 to 15 years (2012 – 10 to 15 years).

No impairment was recorded in 2013 and 2012, and the impairment loss recognized in 2008 was not reversed upon transition to IFRS.

c. *Distribution Rights from TECC Services*

On July 11, 2008, the Company acquired the exclusive rights to distribute the ESM™ in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Services Ltd. ("TECC"). Consideration of $1,738,750 (£1,035,000) was payable in cash and $532,067 (£265,000) was payable in the form of common shares of the Company. Upon closing, payment of $873,393 (£435,000) was made and 743,709 shares were issued. The share price was based on the average closing price of the Company's shares on the TSX Venture Exchange for 20 consecutive trading days, with the last of such trading days being the second day preceding the date of closing as prescribed by trading regulations.

The remaining balance of $1,204,680 (£600,000) was due in scheduled instalments over four years with the last payment due on July 16, 2012. These instalments were non-interest bearing. At the acquisition date, the fair value of consideration was determined to be $2,270,800 based on discounting the future payments at a rate of 16%. Transaction costs of $28,300 were also incurred.

The purchase agreement was amended on December 21, 2009 where payments were rescheduled with the first payment due on January 16, 2010 and the last one on July 16, 2012. The parties also agreed that interest would accrue on $118,493 (£75,000) at Royal Bank of Canada prime rate plus 4% from January 16, 2009 and additionally on $118,493 (£75,000) from July 16, 2009 until these amounts are fully paid. The amendment had no material impact on the Company's financial position and no gain or loss was recognized in 2009. During the year ended December 31, 2012, all parties agreed to accrue interest on the full outstanding balance at Royal Bank of Canada prime rate plus 4% effective on January 1, 2012.

On December 10, 2013, the parties agreed to reduce the outstanding balance of $886,714 (£508,217) including interest of $145,181 (£83,217) to $339,325 (£194,500) (note 11).

During the year ended December 31, 2013, management reassessed the useful life of the distribution rights from TECC to be 9.5 years (2012 – 9 years).

d. *Intangible assets from Smartcool UK*

On February 28, 2011, the Company acquired $4,842,731 of intangible assets in relation to the acquisition of Smartcool UK.

These intangible assets include the following definite lived intangible assets: distribution rights of the ESM™ in the United Kingdom, the distribution right related to sales to a major customer and a customer relationship. The remaining balance of the intangible assets acquired related to goodwill which is an indefinite life intangible asset. The expected life of the definite life intangible assets was determined to be 5 years.

Distribution rights – General	$595,884
Distribution rights - Major customer	1,974,978
Customer relationship	1,058,584
Goodwill	1,213,285
Total	**$4,842,731**

During the year, total amortization of $262,316 (2012 - $570,204) was recorded against the asset costs.

In 2011, management performed a review of the carrying value of these assets. As discrepancies between revenue projections and actual operating results in 2011 have resulting in significant uncertainty in future cash generation of these assets, an impairment loss was recorded as at December 31, 2011 based on cash flow projections at this time. The value of goodwill was written off and the other assets were impaired as follows:

	Impairment
Distribution rights - General	$104,919
Distribution rights - Major customer	347,740
Customer relationship	188,484
Goodwill	1,213,285
Total impairment for the year ended December 31, 2011	**$1,854,428**

During the year ended December 31, 2013, management reassessed the useful life of the intangible assets from Smartcool UK to be 12 years (2012 – 5 years).

No impairment losses were recorded in 2013 and 2012, and the impairment loss recognized in 2011 was not reversed.

8. Capitalized Development Costs

During the year ended December 31, 2013, the Company incurred $29,430 of research and development costs that were fully expensed (2012 - $29,667). No research and development costs were deferred during the year ended December 31, 2013 (2012 – Nil).

9. Warranty Provision

	December 31, 2013	December 31, 2012
Balance, beginning of year	$27,015	$30,462
Change in provision made during the year	(5,460)	(6,672)
Provisions used during the year	(1,158)	(885)
Effect of change in foreign exchange	(2,575)	4,110
Balance, end of year	**$17,822**	**$27,015**

The Company provides a one to five year warranty to repair or replace defective components with respect to its product sales. The warranty provision in this year's consolidated financial statements includes management's best estimate from historical data of the total costs of all raw materials and labour required to repair all known issues related to all products that were sold and shipped prior to year end. Included in accrued liabilities as at December 31, 2013 is $17,822 (2012 – $27,015) related to accrued warranty liability.

10. Short-term Loan

On May 20, 2013, the Company obtained a short term loan of $125,000 from an investor. The loan had annual interest rate of 6% and matured in three months, on August 20, 2013. The loan's maturity date has been extended to December 31, 2013 and interest rate reset to 8%. The Company is the process of renegotiating certain terms related to the short-term loan (note 23).

Interest expense for the year ended 31 December 2013 was $6,111 (2012 - $Nil). As at December 31, 2013, the outstanding balance was $131,111 (2012 - $Nil), including accrued interest.

11. Obligations Under Acquisition Contracts

TECC Services

On July 11, 2008, the Company acquired the exclusive rights to distribute the ESMTM in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Consideration of $1,738,750 (£1,035,000) was payable in cash and $532,067 (£265,000) was payable in the form of common shares of the Company. Upon closing, payment of $873,393 (£435,000) was made and 743,709 shares were issued. The remaining balance of $1,204,680 (£600,000) was due in scheduled instalments over four years with the last payment due on July 16, 2012. The obligation amount of $1,204,680 (£600,000) was originally non-interest bearing and has been recorded at its present value using a discount rate of 16%. The purchase agreement was then amended in 2009 and again in 2012 to accrue interest at Royal Bank of Canada prime rate plus 4% and to adjust timing and amount of repayments (note 7).

As at December 10, 2013, the balance of $886,714 (£508,217), including accrued interest of $145,181 (£83,217), was outstanding. The Company was able to negotiate a debt reduction; the existing obligation was extinguished and replaced with two new obligations. These new obligations have principal amounts of $226,798 (£130,000) and $112,527 (£64,500), are non-interest bearing, unsecured, and will be paid in annual installments over 5 years starting December 15, 2014 (note 7).

The fair values of the new obligations have been determined to be $155,182 (£88,950) and $73,317 (£42,025) based on discounting the future payments at 16%. The obligations under the acquisition contract are being accreted to their face value over their term. The accretion charge for the period is recorded within interest expense in the consolidated statement of operations.

Balance – January 1, 2012	**$717,495**
Payment	(38,525)
Accretion	33,461
Accrued interest	47,169
Foreign exchange	17,011
Balance – December 31, 2012	**$776,611**
Accrued interest	45,968
Foreign exchange	64,135
Debt reduction	(658,215)
Balance – December 10, 2013	**$228,499**
Accretion	2,154
Foreign exchange	2,372
Balance – December 31, 2013	**$233,025**
Less: Current portion	(31,506)
Balance	**$201,519**

This debt settlement resulted in a gain of $658,215 which has been recognized in the statement of operations for the year ended December 31, 2013 (2012 - $Nil).

Smartcool UK

On February 28, 2011, the Company acquired the business of Smartcool UK for total cash consideration of $4,410,745 (£2,840,438) and some non-cash consideration (note 7). Upon closing, $2,922,622 (£1,840,438) was settled in cash with the remaining balance of $1,582,200 (£1,000,000) due in four equal installments over the next 12 months. The Company was unable to make the first quarterly payment as scheduled.

As at December 10, 2013, principal balance of $1,744,600 (£1,000,000) and accrued interest of $285,274 (£163,517) were outstanding. The Company was able to negotiate a debt reduction; the existing obligation was extinguished and replaced with two new obligations. These new obligations have principal amounts of $130,845 (£75,000), which is non-interest bearing, secured, and will be paid in installments over 6 months, and $53,210 (£30,500), which is non-interest bearing, unsecured, and will be paid in installments over 5 years. Fees of $2,291,510 (£1,300,000) will be payable by the Company if it defaults on any of the prepayment terms with respect to the obligation with a principal amount of £75,000.

Their fair values have been determined to be $126,048 (£72,250) and $40,230 (£23,060), respectively, based on discounting the future payments at 10%. The obligations under the acquisition contract are being accreted to their face value over their term. The accretion charge for the period is recorded within interest expense in the consolidated statement of operations.

Balance – January 1, 2012	**$1,593,856**
Accretion	6,439
Accrued interest	118,549
Foreign exchange	40,902
Balance, December 31, 2012	**1,759,746**
Accrued interest	122,072
Foreign exchange	148,056
Balance, December 10, 2013	**2,029,874**
Debt reduction	(1,863,596)
Balance, December 10, 2013	**166,278**
Accretion	980
Foreign exchange	1,724
Balance, December 31, 2013	**168,982**
Less: Current portion	(134,789)
Balance	**$34,193**

This debt settlement has resulted in a gain of $1,863,596 which has been recognized in the statement of operation for the year ended December 31, 2013 (2012 - $Nil).

TECC and Smartcool UK Modified Acquisition Obligations	TECC 1	TECC 2	UK 1	UK 2	Total
New Balance, December 10, 2013	**$155,182**	**$73,317**	**$126,048**	**$40,230**	**$394,777**
Accretion	1,463	691	743	237	3,134
Foreign exchange	1,611	761	1,307	417	4,096
Balance – December 31, 2013	**158,256**	**74,769**	**128,098**	**40,884**	**402,007**
Less: Current portion	(20,654)	(10,852)	(128,098)	(6,691)	(166,295)
Balance	**$137,602**	**$63,917**	**$-**	**$34,193**	**$235,712**

12. Finance Leases

Under the agreement of Smartcool UK acquisition, the Company assumed Smartcool UK's liabilities including five vehicle leases (notes 6 and 18). They have implied annual interest rate ranging from 5% to 10%. These leases expired in April 2012 and August 2013.

Required undiscounted repayments are as follows:

Finance lease payments	
2013	$22,320
Less: Interest	(2,911)
Balance, December 31, 2012	**$19,409**
Payments	(19,409)
Balance, December 31, 2013	**$-**

The carrying value of the lease asset as at December 31, 2013 was $11,183 (2012 - $40,876) (note 6).

13. Debentures

In 2010, the Company issued 122 units of debenture and share purchase warrants for aggregate proceeds of $610,000. The debenture is not redeemable by the holder.

Each unit comprised a debenture in the principal amount of $5,000 plus 8,600 warrants, issued at a price of $5,000 per unit. They are for a term of three years and entitle the holder to receive interest payment of $150 each quarter per $5,000 of principal amount with an additional interest payment of $150 if the debenture is repaid by December 31, 2011 and two additional interest payments (for a total of $300) if the debenture is repaid after December 31, 2011, but before maturity. The debentures receive 5% of gross cash revenue as principal repayment each quarter. The debentures are secured by a general security agreement over the assets of the Company. The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date.

One whole warrant entitles the holder to purchase one common share at the price of $0.50 per share for a period of three years from the date of issuance. If the Company's share trade at an average price of $0.80 per share for a period of 60 days, the Company, at its election, may force exercise or cancellation of the warrants. If the Company repays any portion of the principal amount of the debentures prior to January 1, 2011, the number of common shares purchasable pursuant to the warrants shall be decreased proportionately to the amount of principal so repaid.

Finder's fees equal to 10% of the aggregate proceeds from the offerings of the units were payable to the brokers.

On February 9, 2010, the Company closed the first tranche of its debenture offering for gross proceeds of $250,000. On March 19, 2010, the Company closed the second tranche for gross proceeds of $85,000. On April 29, 2010, the Company closed the third tranche for gross proceeds of $200,000 and on May 4, 2010, closed the last tranche of its debenture offering for gross proceeds of $75,000.

The net proceeds received from the issue of debentures have been split between the financial liability component and an equity component using the residual method. The fair values of debentures and share purchase warrants were allocated as follows:

Net proceeds of issue	$ 552,751
Equity component	$ 8,101
Liability component at date of issue	$ 544,650

The equity component of $8,101 was credited to equity, Share Purchase Warrants.

The liability component was measured at amortized cost.

As at December 31, 2013, the outstanding principal balance was $272,980 (2012 - $308,490) and the carrying amount of these debentures was $249,083 (2012 - $348,520).

The Company did not make quarterly principal payments under the terms of the debentures and in January 2013 approached all holders of these units requesting an extension of up to two years. The debenture holders have agreed to extend the debentures effectively March 1, 2013 under these terms:

1) Two additional interest payments ($300 per unit) as specified by the original terms will be added to outstanding principal balance.
2) Interest of 12% on outstanding principal amount will be paid quarterly commencing June 1, 2013.

3) With respect to the debentures maturing on March 1, 2014 (46 units), the new principal balance will be repaid in equal quarterly installments in an amount equal to 25% of the principal amount outstanding as at March 1, 2013. These quarterly principal payments will commence on June 1, 2013. With respect to the debentures maturing on March 1, 2015 (71 units), 50% of the new principal balance outstanding as at March 1, 2013 will be repaid in equal quarterly instalments commencing on March 1, 2014 and the remaining 50% will be repaid in one lump sum on March 1, 2015. 3,000 share purchase warrants will be issued for each unit. These warrants have an exercise price of $0.15 and expire on March 1, 2015. The Company paid $20,343 of the March 1, 2014 scheduled principal payment of $50,439 related to its outstanding debentures and is in the process of renegotiating the terms of the remaining $30,096 (note 23).

The Company has received approval from the TSX Venture exchange. The debentures' maturity dates were extended and 351,000 new warrants were issued under the above terms.

Debentures Principal Amount	
Outstanding principal balance, December 31, 2012	$ 308,490
Add: Additional interest payments	$ 36,600
New outstanding principal balance, March 1, 2013	**$ 345,090**

Debentures Carrying Amount	
Balance at January 1, 2012	**$497,008**
Accrued interest	53,467
Principal payments	(128,755)
Interest payments	(73,200)
Balance at December 31, 2012	**$348,520**
Accrued interest, January 1 to February 28, 2013	13,364
Interest payments, January 1 to February 28, 2013	(24,400)
Balance at March 1, 2013 before extension	**$337,484**
Loss on debt extinguishment	$7,606
Balance at March 1, 2013 before measurement of warrants	**$345,090**

The terms of the debenture extension were significantly different from the original terms which resulted in a loss on debt extinguishment of $7,606, which has been netted with the gain on debt settlement (note 11).

The new principal amount has been split between financial liability component and equity component using the residual method. The fair values of debentures and share purchase warrants are as follows:

New principal amount, March 1, 2013	$ 345,090
Liability component, March 1, 2013	$292,397
Equity component	$52,693

The equity component of $52,693 has been credited to reserve for equity settled share based transactions (note 14(c)).

The liability component is measured at amortized cost.

Maturity date	**March 1, 2014**	**March 1, 2015**	**Total**
Balance at March 1, 2013	$77,768	$214,629	$292,397
Accrued interest	12,014	45,172	57,186
Interest payments	(5,668)	(22,722)	(28,390)
Principal payments	(52,129)	(19,981)	(72,110)
Balance at December 31, 2013	**$31,985**	**$ 217,098**	**$ 249,083**
Less: Current portion	(31,985)	(117,727)	(149,712)
Balance	**$ -**	**$99,371**	**$99,371**

During 2013, total interest expenses were $70,550 (2012 - $53,467), calculated by applying weighted average effective interest rate of 26% to the liability component of the original debenture for the period from January 1 to February 28, 2013 ($13,364) and 26% to the liability component of the extended debenture for the period from March 1 to December 31, 2013 ($57,186).

Interest payments totaling $52,790 (2012 - $73,200) and principal payments totaling $72,110 (2012 - $128,755) were paid during 2013.

As at December 31, 2013, the outstanding principal balance was $272,980 (2012 - $308,490) and the carrying amount of these debentures was $249,083 (2012 - $348,520).

14. Issued Capital and Equity Reserve

Authorized

Unlimited common shares without par value
100,000,000 Class A preferred shares
100,000,000 Class B preferred shares

a. ***Issued common shares***

	Shares	Amount
Balance, January 1, 2012	**61,608,726**	**$29,465,469**
Issued for cash via private placements (i)	2,678,571	375,000
Share issuance costs	-	(5,077)
Balance, December 31, 2012	**64,287,297**	**$29,835,392**
Issued for cash via private placements (ii)(iii)	15,000,000	500,000
Share issuance costs	-	(26,317)
Balance, December 31, 2013	**79,287,297**	**$30,309,075**

i. On January 20, 2012 the Company completed a non-brokered private placement consisting of 2,678,571 common shares at a price of $0.14 per share for gross proceeds of $375,000. Cash issuance costs of $5,077 were allocated to common shares.

ii. On June 7, 2013, the Company completed a non-brokered private placement consisting of 10,000,000 common shares at a price of $0.025 per share for aggregate gross proceeds of $250,000. Cash issuance costs of $15,911 were allocated to common shares.

iii. On September 30, 2013, the Company completed a non-brokered private placement consisting of 5,000,000 common shares at a price of $0.05 per share for aggregate gross proceeds of $250,000. Cash issuance costs of $10,406 were allocated to common shares.

b. ***Stock options***

Under the Company's stock option plan, the Company may grant stock options to employees, directors, officers and consultants. The maximum number of shares to be awarded under the plan is 12,161,745.

In October 2010, the stock option plan was amended to extend the option term to a maximum period of ten years. This amendment was approved by shareholders at 2010 annual general meeting and accepted for filing by the TSX Venture Exchange.

As at December 31, 2013, all outstanding options have vesting periods of up to 5 years. A summary of the Company's stock option activity for employees, directors, officers and consultants is as follows:

	Number of share options	Weighted average exercise price
Balance, January 1, 2012	5,610,000	$0.31
Granted	805,000	0.20
Cancelled	(192,500)	0.38
Forfeited	(1,057,500)	0.31
Expired or exercised	(1,265,000)	0.33
Balance, December 31, 2012	3,900,000	0.28*
Granted	2,880,000	0.05
Forfeited	(120,000)	0.53
Expired or exercised	(225,000)	0.23
Balance, December 31, 2013	**6,435,000**	**$0.08**

* 0.13 after repricing

In June 2013, the Company reduced the exercise price of 3,525,000 previously granted stock options held by employees, consultants and insiders of the Company (ranging from $0.20 to $0.33 per share) to an exercise price of $0.10 per share. This resulted in an incremental fair value of $38,283, calculated as the difference between the total fair value of the repriced stock options immediately before and after the modification.

The fair value of the repriced stock options has been estimated using the Black-Scholes Option Pricing Model assuming a risk free rate of 1.01% to 1.20%, an expected life of 2.54 years, an expected volatility between 104.69% to 139.51%, and no expected dividends.

Of the 3,525,000 options, 605,000 options were granted on December 23, 2009, 550,000 options were granted on January 12, 2010, 870,000 options were granted on December 22, 2010, 345,000 options were granted on April 1, 2011, 30,000 options were granted on June 7, 2011, 50,000 options were granted on July 25, 2011, 300,000 options were granted on October 1, 2011 and 775,000 options were granted on January 26, 2012. All of the options have a five year term. There was no change in the option expiry date. The re-pricing of the stock options has been approved by the TSX Venture Exchange.

The re-pricing of 2,935,000 insider options has been approved by disinterested shareholders at the Company's August 30, 2013 annual general meeting.

As at December 31, 2013, 6,435,000 (December 31, 2012 - 3,900,000) options were outstanding. These options have vesting periods of up to 5 years and weighted average exercise price of $0.08 (December 31, 2012 - $0.28). During the year ended December 31, 2013, the Company granted 2,730,000 options with weighted average fair value of $0.035 (2012 – 805,000, weighted average fair value $0.11) to officers and employees and 150,000 options with weighted average fair value of $0.035 (2012 – Nil) to consultants. None of these options had an exercise price lower than the stock price at the date of grant (2012 – Nil).

Share-based payments for the year ended December 31, 2013 was $82,278 (2012 - $123,158) of which $75,978 (2012 – $102,168) was related to employees and $6,300 (2012 - $20,990) was related to consultants.

Additional information regarding share options outstanding at December 31, 2013, is as follows:

	Options Outstanding			Options Exercisable	
Range of exercise prices	**Number of options**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**	**Number of options**	**Weighted average exercise price**
$0.05 - $0.09	2,850,000	4.97	$0.05	712,500	$0.05
$0.10 - $0.19	3,555,000	2.03	$0.10	3,540,000	$0.10
$0.20 - $0.33	30,000	2.50	$0.30	30,000	$0.30
	6,435,000	**3.34**	**$0.08**	**4,282,500**	**$0.09**

The Company used the Black-Scholes Option Pricing Model to determine the fair value of the options at the date of grant with the following assumptions:

	2013	2012
Risk-free interest rate	1.35% - 1.51%	1.23% - 1.53%
Dividend yield	0%	0%
Volatility	107.72% - 111.49%	90.61% - 93.96%
Expected life	5 years	4.44 years

c. ***Share purchase warrants***

i. On February 22, 2011, the Company issued 13,333,330 units of commons shares and warrants pursuant to a non-brokered private placement. Each unit consists of one common share and one-half warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.45 until February 22, 2013. These warrants are not transferable. A total value of $707,333 was attributed to the warrants. Cash issuance costs of $38,461 and non-cash issuance costs of $8,310 were allocated to these warrants.

ii. Pursuant to the February 22, 2011 private placement agreement, the Company also issued 626,667 share purchase warrants as non-cash compensation to agents. Each warrant entitles the holder to purchase one common share at a price of $0.30 until February 22, 2012. A total value of $47,000 was attributed to these warrants.

iii. On February 28, 2011, the Company issued 1,000,000 share purchase warrants as non-cash consideration for Smartcool UK acquisition. Each warrant entitles the holder to purchase one common share at a price of $0.30. These warrants will vest 25% on the issuance date and 25% every six months thereafter. They will expire two years from the vesting date. A total value of $227,675 was attributed to the warrants (note 22).

iv. On December 6, 2011, the Company issued 800,000 Units of commons shares and warrants pursuant to a non-brokered private placement. Each Unit consists of one common share and one-half warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.30 until December 6, 2013. These warrants are not transferable. A total value of $12,650 was attributed to the warrants.

v. Pursuant to the terms of March 1, 2013 debenture extension, the Company issued 351,000 share purchase warrants to debenture holders. Each warrant entitles the holder to purchase one common share at a price of $0.15 until March 1, 2015. The fair value of these warrants has been determined to be $52,693, using residual method (note 13).

As at December 31, 2013, there were 851,000 (2012 - 9,115,865) outstanding warrants with weighted average share price of $0.24 (2012 - $0.43).

A summary of the Company's reserve for equity settled share based transactions is as follows:

	Number outstanding	Amount
Balance, January 1, 2012	**9,742,532**	**$955,710**
Expired	(626,667)	(47,000)
Balance, December 31, 2012	**9,115,865**	**$908,710**
Granted (note 13)	351,000	52,693
Expired	(8,615,865)	(834,635)
Balance, December 31, 2013	**851,000**	**$126,768**

Share purchase warrants outstanding as at December 31, 2013 were as follows:

	Number of warrants	Weighted average share price
Balance, January 1, 2012	**9,742,532**	**$0.42**
Expired, exercised or cancelled	(626,667)	0.30
Balance, December 31, 2012	**9,115,865**	**$0.43**
Granted (note 13)	351,000	0.15
Expired, exercised or cancelled	(8,615,865)	0.44
Balance, December 31, 2013	**851,000**	**$0.24**

Expiry date	Number of shares	Exercise price	Weighted average contractual life (years)
February 28, 2014 (note 22)	250,000	0.30	0.16
August 28, 2014	250,000	0.30	0.66
March 1, 2015 (note 13)	351,000	0.15	1.16
Total issued and outstanding, December 31, 2013	**851,000**	**$0.24**	**0.72**

15. Income Taxes

Income tax recognized in the statement of operations:

Deferred income tax recovery	$31,523
Current income tax expense	(13,512)
	$18,011

A reconciliation of expected tax recovery based on accounting loss at statutory tax rates to actual income tax recovery recorded:

	December 31, 2013	December 31, 2012
Expected tax expense (recovery) (2013 – 26%; 2012 – 25%)	101,474	(577,600)
Permanent and other differences	(194,983)	43,163
Effect of foreign tax rates	(137,438)	(17,474)
Change in unrecognized tax assets	212,936	173,784
Income tax recovery	**($18,011)**	**($378,127)**

Unrecognized income tax assets comprise the following:

	December 31, 2013	December 31, 2012
Deferred income tax assets		
Non-capital losses	5,310,773	5,042,153
Share issuance costs	31,285	39,505
Other timing differences	117,662	165,126
Unrecognized tax assets	$5,459,720	**$5,246,784**

The Company's operations are conducted in a number of countries with complex tax legislation and regulations pertaining to the Company's activities. Any reassessment of the Company's tax filings by the tax authorities may result in material adjustments to net income or loss, tax assets and operating loss carry-forwards.

In assessing the ability to realize deferred tax assets, management considers whether it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. As management believes there is uncertainty regarding the realization of these deferred tax assets, they have been classified as unrecognized tax assets as at December 31, 2013 (2012 - $5,246,784).

At December 31, 2013, the Company has unused non-capital losses of approximately $18,033,412 available to offset taxable income of future years. The non-capital losses will expire as follows:

	Canada	USA	UK	UK	Total
Tax rate	**26%**	**40%**	**23.25%**	**20%**	
2014	$506,594	$-	$-	$-	$506,594
2015	979,602	-	-	-	979,602
2016	1,023,014	136,046	-	-	1,159,060
2017	1,732,657	1,010,551	-	-	2,743,208
2018	1,127,657	1,733,213	-	-	2,860,870
2019	2,501,267	884,949	-	-	3,386,216
2020	910,879	873,693	-	-	1,784,572
2021	786,254	482,479	61,052	341,586	1,671,371
2022	400,145	187,245	-	954,627	1,542,017
2023	276,367	129,023	-	994,512	1,399,902
	$10,244,436	**$5,437,199**	**$61,052**	**$2,290,725**	**$18,033,412**

Deferred Tax Liabilities

The Company recorded deferred tax liabilities of $1,078,565 as a result of the acquisition of Smartcool UK assets in February 2011. In 2013, these liabilities were reduced by $31,523 (2012 - $135,833) upon the recognition of amortization and impairment costs of these assets.

As at December 31, 2013, deferred tax liability was $445,754.

Deferred income tax liabilities, February 28, 2011	**$1,078,565**
Amortization of intangible assets	(157,136)
Impairment of intangible assets	(303,698)
Effect of foreign exchange rate	(4,621)
Deferred income tax liabilities, December 31, 2011	**613,110**
Amortization of intangible assets	(147,570)
Effect of foreign exchange rate	11,737
Deferred income tax liabilities, December 31, 2012	**477,277**
Amortization of intangible assets	(67,890)
Effect of foreign exchange rate	36,367
Deferred income tax liabilities, December 31, 2013	**$445,754**

16. Commitments

Premise Lease

The Company has entered into three lease agreements to lease office facilities in Vancouver and Alton, Hampshire. These leases will expire in three years. The future minimum lease payments commitments for the Company's office premises are:

2014	115,155
2015	83,970
2016	10,282
	$209,407

For the year ended December 31, 2013, the Company's rent expense including certain operating expenses and property taxes was $216,968 (2012 - $278,515) and its sublease revenue was $116,028 (2012 - $88,863).

Abbotly USA

Under the terms of the North American distribution rights acquisition, the Company was required to pay a 20% royalty on products identified in the Assignment and Assumption agreement dated March 27, 2006 and purchased from Abbotly Pty for North American sales. The initial term of the agreement was to expire on March 3, 2008. Smartcool, under its rights in the Assignment and Assumption agreement, has renewed the licensing agreement for another five year term. The Company purchased the entire remaining inventory from Abbotly USA, as required under this agreement, and was required to pay a minimum of US$40,000 in royalty annually.

On December 31, 2012, Smartcool decided not to renew the Distribution agreement, expiring on March 6, 2013 (note 7). As a result of this termination, all rights and obligations under the assignment and assumption agreement between Smartcool and Abbotly USA expired on March 6, 2013. The related distribution rights remained with International as Abbotly USA has decided not to renew the distribution agreement.

The Company recorded no royalty expense (2012 - US$40,000) for the year ended December 31, 2013.

Debenture

The Company has a commitment to make principal repayments and interest payments related to debentures issued (note 13).

17. Segmented Information

The Company installs, distributes, markets and sells the ECO3 and ESM™ products and peripherals. Revenue from the ECO3 for the year was $629,412 (2012 - $486,281) and revenue for the ESM™ solution was $1,038,545 (2012 - $3,726,469).

The Company operates in one segment. Revenue was derived from customers located in the following geographical regions:

	2013		2012	
	Amount	**%**	**Amount**	**%**
Europe, Middle East, Africa	$809,840	49	$3,196,120	76
Australia	503,798	30	502,944	12
South East Asia	-	-	-	-
Americas	354,319	21	513,686	12
Total revenue	**$1,667,957**	**100**	**$4,212,750**	**100**

Revenue per region was determined based on the location of the customer or their billing address.

During the year ended December 31, 2013, revenue from two customers exceeded 10% of the Company's total revenue. These customers contributed 30% (2012 – 12% of total revenue) and 22% (2012 – 0% of total revenue), respectively.

Property and equipment are located in:

	2013		2012	
	Amount	**%**	**Amount**	**%**
Canada	$63,058	75	$91,851	58
UK	19,871	24	64,199	41
USA	484	1	46	-
Other	421	-	973	1
Total	**$83,834**	**100**	**$157,069**	**100**

18. Related Party Transactions

Trading Transactions

The Company's related parties consist of companies owned by executive officers and directors and key management as follows:

	Nature of Transaction
384518 BC Ltd.	Consulting services
Windstone Financial Corp.	Consulting services
Richards Buell Sutton LLP	Legal services
Accupro Trademark Services LLP	Trademark services
Albion Management	Rent expense
Magnum Energy Inc.	Rental income
T.E.C.C. Services Ltd.	Vehicle lease payments

The Company incurred the following expenses in connection with the companies owned by key management and directors. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

	Note	2013	2012
Consulting fees	(i)	$44,025	$54,000
Legal fees	(ii)	7,600	6,336
Rent expense	(iii)	-	19,093
Rental income	(iv)	-	(3,000)
Vehicle lease payments	(v)	22,320	35,361
Loss on sale of property and equipment	(vi)	-	1,777
		$73,945	**$113,567**

i. During the year ended December 31, 2013, consulting fees of $44,025 were charged by two companies with common directors during the above period (2012 - $54,000). As at December 31, 2013, $57,015 was owed to the related parties (2012 - $56,000).

ii. The Company uses the services of a law firm of which a director is a partner. During the year ended December 31, 2013, fees in the amount of $7,600 (2012 - $6,336) were charged to the Company for legal services provided. As at December 31, 2013, $22,531 was owed to this related party (2012 - $14,504).

iii. The Company rented its Vancouver office from a management firm of which a director is a partner. During the year ended December 31, 2013, rent expense was $Nil (2012 - $19,093). These transactions have been charged to general and administrative in the statement of operations. At December 31, 2013, no amounts were owed to this related party (2012 - $Nil). During the year ended December 31, 2013, the Company rented its office in the United Kingdom from a company with a director in common in the amount of $Nil (2012 - $Nil). At December 31, 2013, no amounts were owed to this related party (2012 - $Nil).

iv. The Company subleased its Vancouver office and other facilities to a company with a common officer. During the year ended December 31, 2013, sublease income was $Nil (2012 - $3,000). At December 31, 2013, $Nil was owed to this related party (2012 - $7,646).

v. During the year ended December 31, 2013, vehicle lease payments of $22,320 were paid to a company with two common directors during the above period (2012 - $35,361). As at December 31, 2013, $Nil was owed to this related party (2012 - $22,320) (note 6).

vi. During the year ended 31 December 2013, the Company sold property and equipment for proceeds of $Nil (2012 - $2,223) resulting in a loss of $Nil (2012 - $1,777) related to property and equipment sold to a law firm in which a director is a partner (note 6).

Due to/from Related Parties

Included in trade and other receivables is $5,000 due from the Chief Executive Officer as at December 31, 2013 (2012 - $5,000) related to an advance for travel expenses. The amount is unsecured, non-interest bearing and have no fixed terms of repayment (note 4).

Included in trade payables is $219,381 due to related parties as at December 31, 2013 (2012 - $211,127) as follows:

	2013	2012
Chief Executive Officer	29,470	12,880
Chief Financial Officer	22,014	12,723
Director of the Company	2,072	4,238
Executive VP	19,390	9,630
VP of Operations	21,152	28,946
Other related parties	125,283	142,710
Total	**219,381**	**211,127**

The amounts due to related parties are unsecured, non-interest bearing and have no fixed terms of repayment.

Compensation of Key Management Personnel

The Company incurred the following expenses in connection with compensation of key management personnel. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, and consist of the Directors, Chief Executive Officer, Chief Financial Officer, Executive Vice-President and Vice-President Operations.

	2013	2012
Salaries	$502,150	$601,137
Short-term benefits	-	33,228
Share-based payments	75,273	63,630
Bonus settlement	-	17,794
	$577,423	**$715,789**

19. Financial Instruments

Financial Instruments

The Company has classified its financial instruments as follows:

	December 31, 2013	December 31, 2012
Financial assets		
FVTPL , measured at fair value:		
Cash and cash equivalents	$28,036	$247,150
Loans and accounts receivable, recorded at amortized cost:		
Trade and other receivables	245,719	747,684
	$273,755	**$994,834**
Other financial liabilities, recorded at amortized cost		
Trade payables	$594,685	$696,514
Short-term loan	131,111	-
Acquisition obligations, finance leases and debentures	651,090	2,904,286
	$1,376,886	**$3,600,800**

Interest income from FVTPL and interest expense from short-term loan, acquisition obligations, debentures and other financial liabilities are recognized in finance income and expense.

Financial instruments recorded at fair value are measured using a three-level fair value hierarchy:

- Level 1: fair value is determined by reference to quoted prices in active markets for identical assets and liabilities.
- Level 2: fair value is determined based on inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly.
- Level 3: fair value is determined based on inputs that are unobservable and significant to the overall fair value measurement.

The carrying value of cash and cash equivalents, trade and other receivables, obligations under acquisition contract, finance leases, debentures and trade payables approximates the fair value because of the short-term nature of these instruments.

Financial Risk Management

The Company is exposed to certain financial risks, including credit risk, liquidity risk, and market risk.

a. *Credit risk*

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash and cash equivalents and trade and other receivable. The Company limits its exposure to credit loss by placing its cash and cash equivalents and short-term investments with high credit quality financial institutions. To mitigate credit risk with respect to trade receivables the Company subjects all major customer accounts to its credit evaluation process.

The Company has $240,719 (2012 - $742,684) in trade receivables which are subject to credit risk.

b. *Liquidity risk*

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and the settlement of liabilities in the normal course of business. Liquidity risk results from the Company's inability to meet its financial obligations when they become due. As part of the risk management process, the Board approves the Company's annual operating and capital budgets as well as any material transactions outside the ordinary course of business. To ensure that the Company has sufficient liquidity to meet its current obligations in the next 12 months, measures have been taken to increase cash resources (note 1).

The timing of future payments related to financial liabilities is outlined in the table below:

	Total	1 year	1-2 years
Trade payables	$594,685	$ 594,685	$-
Premises leases	199,124	115,155	83,969
Short-term loan	131,111	131,111	-
Debentures	249,083	149,712	99,371
Obligations under acquisition contracts	402,007	166,295	235,712
Total	**$ 1,576,010**	**$ 1,156,958**	**$ 419,052**

c. *Market risk*

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or valuation of its financial instruments.

d. *Foreign currency risk*

The Company is exposed to fluctuations in foreign currency as most of its international distribution transactions are settled in U.S. dollars, Australian dollars, Canadian dollars and British pounds. The Company's net income and cash flow will therefore be affected by fluctuations in foreign exchange rates. None of these risks has been mitigated through the use of foreign currency forward contracts.

As at December 31, 2013, the Company's monetary assets and liabilities denominated in foreign currencies are as follows:

	USD	AUD	GBP	Euro
Assets				
Cash and cash equivalents	$4,027	$86	£-	€5
Trade and other receivables	109,567	-	-	3,339
Total	**$113,594**	**$86**	**£-**	**€3,344**
Liabilities				
Trade payables	$33,146	$5,828	£28,500	€13,818
Acquisition obligations, current	-	-	6,156	-
Total	**$33,146**	**$5,828**	**£34,656**	**€13,818**

The following table demonstrates the effect of exchange rate movement on net income due to gains and losses on the revaluation of monetary assets and liabilities denominated in foreign currencies:

Gain (loss) on $0.10 increase in CAD	USD	AUD	GBP	Euro
Monetary assets	($11,359)	($9)	£-	(€334)
Monetary liabilities	3,315	583	2,850	1,382
Net gain (loss)	**($8,044)**	**$574**	**£2,850**	**€1,048**

Gain (loss) on $0.10 decrease in CAD	USD	AUD	GBP	Euro
Monetary assets	$11,359	$9	£-	€334
Monetary liabilities	(3,315)	(583)	(2,850)	(1,382)
Net gain (loss)	**$8,044**	**($574)**	**(£2,850)**	**(€1,048)**

e. ***Interest rate risk***

The Company is not exposed to this risk. TECC and Smartcool acquisition obligations have been modified and are no longer bearing interest based on Royal Bank of Canada prime rate.

20. General and Administrative Expenses

	2013	2012
Advertising and promotion	16,070	32,882
Bad debt expense	45,377	19,139
Consulting	280,860	360,342
Commissions	779	22,633
Director fees	-	6,964
Filing and transfer fees	16,391	20,109
Insurance	50,807	66,434
Interest	1,204	-
Investor relations	8,113	9,687
Rent	220,512	277,396
Office and supplies	88,332	151,576
Product certification	7,238	9,947
Salaries and benefits	1,263,215	1,767,388
Professional fees	107,147	147,838
Telephone	43,006	63,853
Travelling	159,292	253,146
Total	**2,308,343**	**3,209,334**

21. Capital Management

The Company's capital structure includes debentures and shareholders' equity consisting of share capital, reserve for equity settled share based transactions and deficit. As at December 31, 2013, the principal amount of debenture component was $272,980 (2012 - $308,490) and shareholders' equity was $2,125,233 (2012 - $1,106,782). The decrease in debentures was attributable to principal payments made during the year and the increase in shareholders' equity was attributable to the gain from the settlement of acquisition obligations and additional capital raised through two private placements, partially offset by operating loss.

The Company's objectives when managing capital are:

- to effectively finance its operations and growth by meeting its operating and capital expenditure budgets;
- to maintain financial flexibility in order to meet financial obligations, including obligations under acquisition contracts;
- to ensure its ability to carry out its strategic plans and take advantage of acquisition opportunities;
- to provide an appropriate investment return to its shareholders and maintain investor, creditor and market confidence.

To ensure that the Company continues to be a going concern with adequate working capital through 2014 steps have been taken to monitor expenses and secure more predictable revenue generation.

Management has arranged with a UK bank to have a short term overdraft protection and continued to seek approval from this major banking relationship to provide accounts receivable factoring for select accounts that will smooth out the Company's cash flow.

The Company is not subject to any external capital restrictions.

22. Supplementary Cash Flow Information

	2013	2012
Interest paid in cash (notes 11 and 13)	$ 89,390	$83,128
Interest income received in cash	$77	$196
Issuance of warrants for debenture extension (notes 13 and 14(c))	$52,693	$-

23. Subsequent Events

Subsequent to December 31, 2013, the Company received inventory units back from a customer that went bankrupt for consideration of $Nil.

On February 28, 2014, 250,000 warrants previously granted on February 28, 2011 with an exercise price of $0.30 expired (note 14(c)(iii)).

On March 14, 2014, the Company granted 1,200,000 stock options to consultants of the Company with an exercise price of $0.05 expiring on 14 March 2019.

On March 26, 2014, the Company entered into an investor relations agreement with FronTier Consulting Ltd. ("FronTier") and agreed to pay to FronTier a fee of $4,000 per month commencing April 1, 2014 to April 1, 2015.

On April 1, 2014, The Company paid $20,343 of the March 1, 2014 scheduled principal payment of $50,439 related to its outstanding debentures and is in the process of renegotiating the terms of the remaining $30,096 (note 13).

On April 21, 2014, the Company repaid $70,000 of its short-term loan and is in the process of renegotiating the remaining balance (note 10).

On April 25, 2014, the Company issued 9,730,000 units ("Units"), consisting of one common share and one-half of one share purchase warrant for gross proceeds of $486,500. Each share purchase warrant allows the holder to purchase one common share of the Company at an exercise price of $0.10 per share for a period of 12 months.